No. 15737

United States Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA, *Appellant,*

v.

PETE JOHNSON, F. DOUGLAS MAVOR, JANE KENDLE MAVOR, NELSON T. BRUCE and CLEO BRUCE, *Appellees.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLEES

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JURISDICTION

We concur in Appellant's assertions concerning jurisdiction.

STATEMENT

Appellant's statement of the case requires some emendation.

Thus, at the outset, Appellant's counsel have missed the basic reason for the joinder of Mrs. Mavor and Mrs. Bruce as plaintiffs (B. 3, footnote 1). Actually the reason for their joinder was that as wives of members of a partnership composed of residents of the State of Washington, the distributive share of their husbands in the earnings of that partnership in the State was community income and half of it belonged to the wives. *Poe v. Seaborn,* 282 U.S. 101.

The contract between that partnership (Johnson & Mavor Logging Company) and the owner of the tim-

berland (Puget Sound Pulp & Timber Co.) was negotiated between strangers, dealing at arm's length (R. 26). It is undisputed that the drafts of the proposed written instrument were prepared by counsel for the Owner (R. 28). Such were submitted to Douglas Mavor, as the representative of the partners, who were not represented by counsel. The partners objected to certain provisions of the early draft (R. 27). As a result, changes were made by Owner's counsel before the production of the final form of the contract which was ultimately executed on July 23, 1946. A copy was admitted in evidence as Plaintiffs' Exhibit 4, and it is reproduced *verbatim* in Appellant's Brief at page 23.

Mr. Mavor testified without contradiction that these changes were effected by substituting certain pages in the final form of contract in lieu of earlier pages. He produced a number of typewritten sheets which he identified as being pages from earlier drafts of the contract which were supplanted in the final draft. These earlier pages were offered in evidence as Plaintiffs' Exhibit 5 (R. 29).

Mr. Mavor testified again without contradiction that among the changes so effected was the elimination of a provision in the first proposal that gave the Owner an option to buy the logs produced from the timber, but imposed no obligation upon it to do so. The provision inserted in lieu thereof, he testified, was understood to reverse the option. Instead of giving the Owner the option to buy, the final draft was designed to give the Logger the option to sell to the Owner, but committed the Owner to buy (R. 27).

The initial sentence of paragraph 4 in Plaintiffs' Exhibit 5 is:

> "In consideration of the execution of this contract by the Owner and the granting of the rights herein set forth, the Logger agrees that the Owner shall have a continuing and irrevocable option to purchase from the Logger at current market prices (less the deductions hereinafter set forth) all logs logged by the Logger from the said lands hereinabove described."

The initial sentence of the substituted paragraph 4 of the final form is:

> "The Owner agrees to purchase from the Logger at current market prices as same are defined in paragraph 5 of this contract, all logs (including all species and grades) logged by the Logger from the lands hereinabove described." (B. 26)

The final form contains no covenant by the Logger to sell such logs to the Owner, although in paragraph 6 there is an express promise by the Logger to sell, and by the Owner to buy, pulpwood—which is not here involved (B. 28).

At the conclusion of the trial, Judge Boldt expressed the opinion that, under the above contract, the loggers had the sort of proprietary interest in the logs which entitled them to capital gains treatment on the cutting of the timber under Section 117(k) of the Internal Revenue Code of 1939 (R. 57, 58). He recognized that the instant case was to be distinguished on this ground from *Ellison v. Frank,* 245 F.2d 837, which he had decided against the taxpayer and which was then on appeal to this Court. He finally announced that he would take the instant case under advisement pending the decision of

this Court in the *Ellison* case because, if *Ellison* were reversed, judgment for the taxpayers here must follow, *a fortiori;* whereas even if *Ellison* were affirmed, he would still be inclined to find for the plaintiffs (R. 56-59).

After this Court had handed down its decision in *Ellison,* Judge Boldt wrote to counsel in the instant case, directing the presentation of findings and judgment for the plaintiffs, and saying:

> "Nothing in the Ellison opinion militates against my tentative intention to grant the relief prayed for by the plaintiff in this instance." (R. 9)

Findings of Fact, Conclusions of Law, and a Judgment were thereafter signed and entered. These were expressly approved as to form (R. 14, 16).

Conclusion of Law I, so entered, is as follows:

> "That the contract between plaintiffs and Puget Sound Pulp & Timber Co. gave plaintiffs the contract right to cut timber for sale, which right was held for more than six months and entitled plaintiffs to elect to treat the cutting thereunder as a sale or exchange under the provisions of Section 117(k) of the Internal Revenue Code of 1939."

Appellant's Designation of Point on Appeal is in the following language:

> "That the Court erred in holding that the agreement of July 23, 1946, providing for the purchase of stumpage, cutting thereof, and sale of logs back to the vendor gives the logger a proprietary interest in the timber to entitle them to the election permitted under Section 117(k) of the Internal Revenue Code of 1939." (R. 17, 18)

ARGUMENT

The Judgment of the District Court Is Correct and Should Be Affirmed

The distinguished judge before whom this case was tried, heard the testimony of the witnesses and concluded that under the agreement between Puget Sound Pulp & Timber Company and themselves, the plaintiff taxpayers acquired a contract right to cut timber for sale, which—having been held for more than six months, entitled them to elect to treat the cutting thereunder as a sale or exchange under Section 117(k) of the Internal Revenue Code of 1939 (R. 13). The trial judge heard the testimony concerning the formation of the contract and the testimony concerning the actions of the parties pursuant to it. He concluded that under this agreement, the plaintiffs acquired "the right and license to enter upon the lands described in the contract and remove therefrom all merchantable timber thereon" (B. 23). They had "agreed to pay to the owner for all merchantable timber so cut, logged and removed, stumpage payments" in accordance with a definite schedule set forth in paragraph 3 of the written agreement (B. 25). The trial judge, versed in the law of the State of Washington, knew that when timber is cut under such a contract, title to it passes to the licensee. *Welever v. Advance Shingle Co.,* 34 Wash. 331, 334, 75 Pac. 863. That, the trial judge recognized, was a proprietary interest equivalent to ownership—and these plaintiffs were not mere hired hands, but became the holders of the legal title to the felled timber. This was thereafter bucked, branded and transported by them. Ultimately it was sold and delivered to Puget Sound Pulp & Timber Company (R.

41). The latter paid for the resulting logs, finally acquiescing in the contention of Johnson & Mavor in a dispute concerning the computation of price (R. 46, 47).

We submit that under this state of facts the conclusion of the District Court was eminently correct in holding that within Section 117(k) this constituted "the cutting of timber (for sale . . .) . . . by the taxpayer who . . . has a contract right to cut, such timber. . . . "

While counsel for the Government have now apparently attempted to shift their position, their Designation of Point on Appeal confirms their concession that the transactions between Puget Sound Pulp & Timber Company and Johnson & Mavor amounted to "the purchase of stumpage, cutting thereof, and the sale of logs back to the vendor" (R. 17). It seems to us that this concession must necessarily result in the affirmance of the present judgment.

It is a concession that here the taxpayers were the owners of the timber upon severance, and that they had the right to sell it, and did sell it. This is the direct opposite of the situation in the *Carlen* case. Adopting the language of the Commissioner's brief, the decision in that case says of the taxpayers there involved:

> "They were not owners of the timber either before or after cutting, and had no right to sell it or use it in their own trade or business." (220 F.2d 338, 340)

These taxpayers certainly acquired a proprietary interest in the timber. Upon severance, they had title. During the period of bucking, branding, colddecking and transporting, they retained that title. Under Wash-

ington law, accordingly, risk of loss by fire or theft was upon them during this period. The leading case of *Holt Manufacturing Co. v. Jaussaud,* 132 Wash. 667, 233 Pac. 35, states the rule as follows (p. 669):

> "Where there is an ordinary executory contract of sale of a specific chattel, the general rule is that, if the property agreed to be sold is destroyed before the consummation of the sale, the loss will fall upon the vendor because the title is in him; in other words, under such circumstances the loss follows the title. 24 R.C.L. 494. Thus, if two parties enter into a contract, one agreeing to sell and the other to purchase a designated chattel, payment to be made at the time of delivery, and before the agreement is consummated by delivery the article is destroyed, the loss must be borne by the seller, and he has no rights against the purchaser, nor has the latter any rights against him."

Passing of title to the severed trees and the consequent imposition of the risk of loss upon Johnson & Mavor is, we suggest, but another way of saying that Johnson & Mavor had a proprietary interest in the logs. Such a situation is entirely inconsistent with a mere service contract providing for cutting the owner's timber for him and is conclusive against appellant's contention to this effect (B. 16).

It is not particularly significant that the instant contract contained some stereotyped provisions which are commonly inserted in service contracts. As a government witness readily admitted, such "boiler-plate" provisions designed to protect the owner of the timber against damage to that remaining in his ownership and to insure proper logging are customarily required by

the owner to be inserted in any form of contract whether of the stumpage or the service type (R. 35, 36). The significant factor here, we suggest, is that the instant contract provides for a sale of the stumpage by the Owner, and a purchase of the logs by him. This is not consistent with a mere service contract.

It is significant, also, that the instant contract, unlike the ones in the *Ellison* and *Carlen* cases, made no mention of payment for "services" and had no provision for retention of title by the Owner. On the contrary, the testimony of the witnesses, including those for the government, referred to the payments by Puget Sound under this contract as payments for logs (R. 27, 44-47).

In the *Ellison* case, the taxpayer's lack of a proprietary interest was established by Par. 5 of the contract, providing that the taxpayer had no interest in the logs except his right to compensation, and by Par. 6 of the contract, in which the Owner agreed to pay the taxpayer for his "services." In the *Carlen* case, the taxpayer's lack of a proprietary interest was established by the contractual provisions that the Owner should have title to the logs until they were sold, and that the Owner was to pay the taxpayer, out of the proceeds, for his "service" (20 T.C. 573, 574-5).

In short, the contract in the instant case was one providing for sales, whereas in the *Ellison* and *Carlen* cases the contracts were service contracts.

ANSWER TO APPELLANT

Counsel for Appellant seek to gloss over the controlling provisions of the instant contractual arrangement by intimating that the provision for sale of stumpage and the provision for the purchase of logs by Puget Sound were mere "window-dressing" and not intended by the parties to have any effect (B. 18). We believe that such a contention is not open to Appellant in view of the fact that no such position was asserted in the trial court (R. 6) and in view of Appellant's Designation of Point on Appeal which recognizes that the agreement provides "for the purchase of stumpage, cutting thereof, and sale of logs back to the vendor" (R. 17). In any event, there is nothing in the record upon which properly to base any such contention and the finding of the District Court was manifestly to the contrary.

In addition counsel for Appellant point out alleged circumstances which they contend tend to indicate that it was not intended that Johnson & Mavor should ever acquire any proprietary interest in the timber.

In this connection they assert first, that the Agreement does not use terms such as "vendor" and "purchaser" (B. 16). This is captious. Under Washington law, as above noted, a license to enter lands with permission to cut and remove timber, to be paid for at an agreed price by the licensee, vests title to the timber in the licensee when so cut. *Welever v. Advance Shingle Co.,* 34 Wash. 331, 334, 75 Pac. 863. Such was the language of the instant contract.

Next they assert that Johnson & Mavor were "given the right to log and remove the timber subject to the

conditions of the contract which provided (Art. 1) that the partnership *'log* and *deliver'* all of the timber to Puget Sound (Italics supplied)" (B. 16). This is not true. "(Art. 1)" merely fixes the time within which the "Logger shall log and deliver all timber from the lands described in this contract." No mention is made therein of Puget Sound (B. 24). The provision with reference to delivery is paragraph 8 (B. 28). This provides:

> "8. All logs cut and removed by the Logger pursuant to this contract (other than pulpwood) shall be transported in trucks by Logger to Owner's Bay Creek boom or its Mt. Vernon boom on the Skagit River, and *all logs purchased by the Owner shall be there delivered."* (Italics ours)

We submit that the foregoing italicized portion clearly supports the testimony below that originally this contract merely gave the Owner an option to buy the logs; and that later paragraph 4 was amended to give the option to the Logger to sell. It is a well-settled rule of law in Washington that where, as here, a contract is prepared by one party any ambiguity is to be resolved against that party and in favor of his opponent. *Willett v. Davis,* 30 Wn.2d 622, 636; 193 P.2d 321. Applying this rule, it is clear that only logs *"purchased"* by Puget Sound were to be *"delivered"* to them.

On page 17 of Appellant's Brief, it is urged that the instant contract guarantees a profit to the Logger. As we read this Court's decision in *Ellison v. Frank,* the incidence of economic risk is not material—the determining factor is the proprietary interest *vel non* in the logs which the taxpayer has the contract right to cut. If this be so, then this inquiry is immaterial. But, in any

case, the assertion is untrue. There was no guarantee in the contract. The price formula nowhere protected Johnson & Mavor in event of a drop in the price of logs, and in the event of log prices remaining stationary, no contribution was to be made to any increased labor costs sustained by Johnson & Mavor, and there was no assurance that the price formula would exceed the sum of Johnson & Mavor's labor costs and their indirect or overhead costs.

Again, Appellant's counsel point to a provision that the logs were to be branded with brands designated by Puget Sound, and with irons furnished by them (B. 17). A reasonable interpretation of this provision, we submit, is that as to logs purchased by Puget Sound, the latter had the right to provide the brands. The undisputed testimony of Mr. Mavor was to the effect that some logs were branded with Johnson & Mavor's own brands (R. 48).

They assert that property taxes on the timber itself were apparently borne by Puget Sound. The record does not support this assertion (R. 35).

They assert that Puget Sound bore the risk of loss of the timber (B. 18). Neither does the record reflect anything to justify this assertion. As we have heretofore pointed out, the risk of loss, from the date of cutting to the date of delivery was, under Washington law, upon Johnson & Mavor.

They point to certain other protective provisions which were inserted in the contract in the interest of Puget Sound (B. 18). As Mr. Clayton E. Rogers, treasurer of Puget Sound Pulp & Timber, testified, these

provisions are usual and common to both stumpage and service contracts (R. 36, 37).

Counsel for Appellant assert that the provision against assignment of the contract by the Logger without permission negatives any proprietary interest in the timber (B. 18). We do not agree. This is a usual protective provision to assure the timber owner that he need only have dealings with a responsible and competent logger. Surely a tenant may be said to have a proprietary interest in a term for years even if the lease contains a provision prohibiting assignment without the landlord's consent.

Finally counsel note that "all the timber cut under the contract was delivered to Puget Sound" (B. 18). Were we inclined to insist upon employment of terms in accord with industry usage, we might answer that no "timber" was delivered to Puget Sound. Much of the confusion in Appellant's Brief stems from a lack of appreciation of the essential difference between "timber" and "logs" as those terms are used in the industry. We concede that Johnson & Mavor sold and delivered to Puget Sound all *"logs"* produced as a result of the operations under the instant contract. Why not? Johnson & Mavor had that right. As long as there was an actual sale and not a sham, the District Court's judgment was right.

CONCLUSION

The judgment of the District Court was right and should be affirmed.

Respectfully submitted,

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